

# SUPREME COURT OF THE UNITED STATES.

No. 567.—OCTOBER TERM, 1925.

Board of Public Utility Commissioners	}	Appeal from the District
et al., Appellants,		Court of the United
vs.		States for the District of
New York Telephone Company.	}	New Jersey.

[April 12, 1926.]

Mr. Justice BUTLER delivered the opinion of the Court.

This is an appeal from a decree of the district court—three judges sitting, § 266, Judicial Code—which granted a temporary injunction restraining the enforcement of certain telephone rates.

The company owns and operates a telephone system in New Jersey, New York and Connecticut. In the territory served in New Jersey there is a number of local areas. Service between telephones in the same area is exchange service, and that between telephones in different areas is toll service. The latter includes both intrastate and interstate business. The system is used to give exchange and toll service to all subscribers. For about 10 years prior to the commencement of this suit the rates in New Jersey remained at substantially the same level. March 6, 1924, the company filed with the Board of Public Utility Commissioners, to take effect April 1, 1924, a schedule providing for an increase of rates for exchange service in New Jersey. The Board suspended the proposed rates pending an investigation as to their reasonableness. December 31, 1924, the increase was disallowed, and the company was required to continue to serve at the existing rates. The Board found that the value of the company's property in New Jersey, as of June 30, 1924, was \$76,370,000; that a rate of return of 7.53 per cent. producing from \$5,750,000 to \$6,000,000 would be a fair return for that year; that the amount charged by the company in 1924 for depreciation, \$3,452,000, was excessive, and that \$2,678,000 was sufficient. And the Board found that net earnings

in 1924 would be \$4,449,000,—less than the fair return by at least \$1,300,000.

The company's accounts are kept according to the uniform system of accounts for telephone companies prescribed by the Interstate Commerce Commission. Charges are made to cover the depreciation in the elements of the plant which for one cause or another will go out of use. These charges are made month by month against depreciation in the operating expense accounts, and corresponding credits are entered in the depreciation reserve account. When a unit or element of the property is retired there is no charge to operating expense, but its original cost less salvage is charged to the reserve account. December 31, 1923, the company's books showed a credit balance in depreciation reserve accounts of \$16,902,530. This was not set aside or kept in a separate fund, but was invested in the company's telephone plant. The Board prescribed a rule for the determination of depreciation expenses to be charged by the company in 1925 and subsequent years. It declared that the credit balance was more than required for the maintenance of the property, and directed that \$4,750,000 of that amount be used by the company to make up deficits in any year when earnings are less than a reasonable return as found by the Board. And it said, "But having made such charges in the past, future charges beginning January 1st, 1925 may be deducted from the normal charge until such time as at least \$4,750,000 of the excess is absorbed as herein after provided." The effect of the order is to require that if total operating expenses deducted from revenues leaves less than a reasonable return in 1925 or a subsequent year, there shall be deducted from the expense of depreciation in that year and added to the net earnings a sum sufficient to make up the deficiency; then, by appropriate book entries, the resulting shortage in depreciation expense is to be made good out of the balance in the reserve account built up in prior years.

On the application for a temporary injunction, the company attacked the findings of the Board as to rate of return, property value, and expense of depreciation. And it contended that the charges on account of depreciation in earlier years were not excessive, and

that in any event the company could not be compelled to make up deficits in future net earnings out of the depreciation reserves accumulated in the past.

The record shows that the rates in effect prior to the temporary injunction were not sufficient to produce revenue enough to pay necessary operating expenses and a just rate of return on the value of the property. There is printed in the margin<sup>1</sup> a statement made by the Board and included in its decision, giving a comparison of results of operation in 1924 under these rates as found by the Board and as estimated by the company. And, in opposition to the motion for the temporary injunction, the Board submitted

Results under Present Rates—Estimated for the Year 1924.

	By Company (Exhibit P-14)	By Board, based on Ex- hibit C-34 modified
Revenues:		
Exchange Revenues .....	\$11,936,000	\$11,936,000
Mail Revenues .....	10,465,000	10,465,000
Miscellaneous Operating .....	257,000	257,000
Total Telephone Revenue .....	\$22,658,000	\$22,658,000
Expenses:		
Office Expenses .....	\$5,846,000	\$5,846,000
Commercial Expenses .....	2,309,000	2,309,000
General and Miscellaneous Expenses .....	548,000	548,000
Collectible Operating Revenues .....	150,000	150,000
Taxes and Other Deductions .....	1283,000	283,000
Current Maintenance .....	13,230,000	3,230,000
Depreciation .....	3,452,000	2,678,000
Interest .....	2,170,000	2,200,000
Balance Revenue, Dr. ....	965,000	965,000
Total Telephone Expenses .....	\$18,953,000	\$18,209,000
Total Telephone Earnings .....	\$3,705,000	\$4,449,000

<sup>1</sup>Include a certain portion of depreciation for right of way from clearing accounts.  
<sup>2</sup>Omits concessions (\$102,000) and interest during construction (\$160,727) aggregating \$262,727 in Exhibit C-34.

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an affidavit containing a statement<sup>2</sup> which set forth in detail the estimated results for 1925 based on the same rates. The affidavit shows net additions to the company's property in New Jersey for 1924, amounting to more than \$13,000,000; and the Board calculates the return on \$88,417,448 as the reasonable value of the property. The calculation is made on three bases: (1) depreciation taken at the company's figure, \$4,128,000, (2) depreciation as found by the Board, \$3,314,716, and (3) depreciation allowed by the Board's order, \$683,430. The effect of the order is to deduct \$2,631,286 from operating expenses found by the Board properly chargeable for depreciation in 1925. This deduction is made at the expense of the property of the company paid for out of depreciation reserves built up in prior years. And it has the same effect on net earnings as would the addition of the same amount of revenue received for service. On the basis of the company's estimate of depreciation expense, the return is 4.12 per

<sup>2</sup>Estimated Rate of Return During Year 1925 under Present Rate Schedule

	Plaintiff's depreciation rate	Board's depreciation rate	Compliance with order of Board
Telephone Revenues:			
Exchange Service.....	\$13,281,000	\$13,281,000	\$13,281,000
Toll Service .....	11,113,000	11,113,000	11,113,000
Miscellaneous .....	316,269	316,269	316,269
Total Telephone Revenues.....	\$24,710,269	\$24,710,269	\$24,710,269
Telephone Expense:			
Current Maintenance .....	\$3,453,400	\$3,453,400	\$3,453,400
Depreciation and Amortization....	4,128,000	3,314,716	*683,430
Traffic .....	6,404,465	6,404,465	6,404,465
Commercial .....	2,657,000	2,657,000	2,657,000
General and Miscellaneous.....	589,166	589,166	589,166
Uncollectibles .....	140,000	140,000	140,000
Taxes .....	2,269,691	2,371,812	2,700,750
Rent Expense and Deductions.....	325,744	325,744	325,744
Miscellaneous Deductions .....	56,813	56,813	56,813
License Contract Expense .....	1,041,695	1,041,695	1,041,695
Total Telephone Expense.....	\$21,065,974	\$20,354,811	\$18,052,430
Net Telephone Earnings.....	\$3,644,295	\$4,355,438	\$6,657,839
Average Cost, \$86,401,736			
% Return on Average Cost.....	4.22	5.04	7.71
Defendant's Average Fair and Reasonable Value, \$88,417,448			
% Return on Value.....	4.12	4.93	7.71

\*Allowing a return of 6% on value of property depreciation and amortization expense will be \$2,163,471.

cent.; on the Board's estimate it is 4.93 per cent.; and by increasing net earnings \$2,631,286, as directed by the order, it is made 7.53 per cent. It is conceded that unless, as directed by the Board, depreciation expense is reduced below what the Board itself found necessary and net earnings are correspondingly increased, the rates cannot be sustained against attack on the ground that they are unreasonably low and confiscatory. Appellants do not contend that the rate of return from the intrastate business is or will be higher than that resulting from the company's business as a whole in New Jersey. And the record supports the claim of the company that the intrastate business or that covered by the exchange rates complained of is not relatively more profitable than the other business of the company.

It may be assumed, as found by the Board, that in prior years the company charged excessive amounts to depreciation expense and so created in the reserve account balances greater than required adequately to maintain the property. It remains to be considered whether the company may be compelled to apply any part of the property or money represented by such balances to overcome deficits in present or future earnings and to sustain rates which otherwise could not be sustained.

The just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the value of the property used at the time that it is being used for the public service. And rates not sufficient to yield that return are confiscatory. *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 41; *Bluefield Co. v. Public Service Commission*, 262 U. S. 679, 692. Constitutional protection against confiscation does not depend on the source of the money used to purchase the property. It is enough that it is used to render the service. *San Joaquin Co. v. Stanislaus County*, 233 U. S. 454, 459; *Gas Light Co. v. Cedar Rapids*, 144 Ia. 426, 434, affirmed, 223 U. S. 655; *Consolidated Gas Co. v. New York*, 157 Fed. 849, 858, affirmed 212 U. S. 19; *Ames v. Union Pacific Railway Co.*, 64 Fed. 165, 176. The customers are entitled to demand service and the company must comply. The company is entitled to just compensation and, to have the service, the customers must pay for it. The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary. Cf. *Fall River Gas Works v. Gas & Electric Light Com'rs*, 214 Mass. 529, 538. The revenue paid by the customers for service belongs

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to the company. The amount, if any, remaining after paying taxes and operating expenses including the expense of depreciation is the company's compensation for the use of its property. If there is no return or if the amount is less than a reasonable return, the company must bear the loss. Past losses cannot be used to enhance the value of the property or to support a claim that rates for the future are confiscatory. *Galveston Electric Co. v. Galveston*, 258 U. S. 388, 395; *Georgia Ry. v. R. R. Comm.*, 262 U. S. 625, 632. And the law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations. Profits of the past cannot be used to sustain confiscatory rates for the future. *Newton v. Consolidated Gas Co.*, 258 U. S. 165, 175; *Galveston Electric Co. v. Galveston*, *supra*, 396; *Monroe Gaslight & Fuel Co. v. Michigan Public Utilities Commission*, 292 Fed. 139, 147; *City of Minneapolis v. Rand*, 285 Fed. 818, 823; *Georgia Ry. & Power Co. v. Railroad Commission*, 278 Fed. 242, 247, affirmed 262 U. S. 625; *Chicago Ry. Co. v. Illinois Commerce Commission*, 277 Fed. 970, 980; *Garden City v. Telephone Company*, 236 Fed. 693, 696.

Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of moneys received for service belongs to the company just as does that purchased out of proceeds of its bonds and stock. It is conceded that the exchange rates complained of are not sufficient to yield a just return after paying taxes and operating expenses, including a proper allowance for current depreciation. The property or money of the company represented by the credit balance in the reserve for depreciation cannot be used to make up the deficiency.

*Decree affirmed.*

Mr. Justice STONE took no part in the consideration of this case.

A true copy.

Test:

*Clerk, Supreme Court, U. S.*